Group Chief Executive's review

Group results
In the 53 weeks to 3 February 2007 total sales rose by 11.5% at constant exchange rates (see page 32); the reported increase was 8.0% to £1,893.2 million (2005/06: £1,752.3 million). Total sales were adversely impacted by 3.5% due to the movement in the average US dollar/pound sterling exchange rate from $1.80/£1 to $1.88/£1 but benefited from the 53rd week which contributed 1.6% to Group sales (see page 32). Like for like sales advanced by 4.8%, with US sales negatively affected by a change in timing of a Valentine's Day 2007 promotional event which moved into the first week of 2007/08. On a 52 week basis to 27 January 2007, which was not affected by this promotional timing difference, like for like sales were up by 5.4%.

Operating profit increased by 10.1% at constant exchange rate (see page 32); the reported increase was 6.3% to £221.4 million (2005/06: £208.2 million). The 53rd week contributed £1.8 million to Group operating profit. Operating margin was 11.7% (2005/06: 11.9%). Profit before tax was up by 10.1% at constant exchange rates (see page 32) and by 6.4% on a reported basis to £213.2 million (2005/06: £200.4 million), the 53rd week contributing £1.5 million. The tax rate was 33.6% (2005/06: 34.7%). Earnings per share rose by 12.3% at constant exchange rates (see page 32) and by 9.3% on a reported basis to 8.2p (2005/06: 7.5p), the 53rd week contributing 0.1p.

The balance sheet remains strong and gearing (net debt to total equity) at 3 February 2007 was 13.4% (28 January 2006: 11.2%). Total investment in fixed and working capital during the year was £158.5 million (2005/06: £147.1 million), predominantly to fund the record number of new stores opened. The return on capital employed ("ROCE") improved to 22.8% (2005/06: 22.4%).

US division
During 2006/07 significant progress was made in implementing the division's strategy of:

- gaining further profitable market share;
- achieving above sector average like for like sales growth; and
- increasing new store space by 8% – 10% per annum.

Total dollar sales increased by 14.9% (13.2% on a 52 week basis, see page 32). The division significantly outperformed the total US jewellery market which grew by 7.1% to $63.1 billion in calendar 2006 (2005: $58.9 billion, Source: US Department of Commerce); its share of the speciality jewellery market was 8.8% (2005: 8.2%). The division's like for like sales rose by 6.2% (on a 52 week basis to 27 January 2007, which was not impacted by the change in timing of a Valentine's Day promotional event, like for like sales were up by 7.0%).

Operating profit rose by 8.6% at constant exchange rates (see page 32). On a reported basis operating profit increased by 4.0% to £173.8 million (2005/06: £167.1 million). The commencement of television advertising for Valentine's Day 2007 in the last week of 2006/07, with the related sales benefit occurring in 2007/08, meant that the 53rd week did not contribute to operating profit.

As part of the $1 billion five year expansion programme announced last year, new store space grew by 11% (2005/06: 9%), slightly above the 8% – 10% target range. This was the largest annual increase since the acquisition of Marks & Morgan in 2000/01. Compound annual growth in new store space over the last five years has been 8%. While Jared accounted for the majority of the space growth over this period, Kay has increased its store base by almost 25% since 3 February 2002. Over the longer term the US division has the potential to almost double store space within the three existing formats of Jared, Kay and the regional brands.

Where appropriate, acceleration of the US division's growth through acquisitions will be considered. However, as always, the Group's strict operational and financial criteria will be applied to any such opportunities.

UK division
The UK division's strategy remains to:

- improve store productivity and operating margin;
- lift the average transaction value; and
- increase diamond participation in the sales mix.

Whilst the retail environment remained challenging, UK operating profit rose 12.0% to £55.0 million (2005/06: £49.1 million), the 53rd week contributing £1.8 million. Like for like sales were up by 1.2%. The division achieved a healthy operating margin of 11.4%, a good ROCE of 32.7% and strong cash flow. Notwithstanding the demanding trading conditions, the average transaction value was up by 10.5% to £63 (2005/06: £57) and diamond sales increased to 30% (2005/06: 29%) of the product mix.

In 2006/07, there was a significant initiative to further differentiate the division's brands within the marketplace by implementing a greater focus on jewellery collections, exclusive ranges and the assortment of diamond merchandise offered. The business continued to emphasise customer service with the launch of major new staff training programmes. The development of television advertising continued with H.Samuel moving to national coverage, and Ernest Jones maintaining a similar level to the prior year. While the number of stores remodelled during the year was fewer than in 2005/06, it was in line with the normal refurbishment cycle. In implementing these initiatives the division continued to draw on the US business' best practice and experience.

Group Chief Executive's review (continued)

Business reviews

US division (75% of Group sales)

Details of the US division's results are set out below:

	2006/07 53 weeks £m	2005/06 52 weeks £m	Change reported %	Change at constant exchange rates[1] %	Like for like change %
Sales	1,410.7	1,282.7	10.0[2]	14.9	6.2[3]
Operating profit	173.8	167.1	4.0[2]	8.6	
Operating margin	12.3%	13.0%			
ROCE	21.5%	22.4%			

(1) See page 32 for reconciliation of impact of exchange rates.
(2) The 53rd week contributed 1.7% to sales and had no impact on operating profit, see page 32
(3) Like for like sales for the 52 weeks to 27 January 2007, which were not impacted by a change in timing of a Valentine's Day promotion, were 7.0%.

Financial performance

The operating margin of 12.3% remained within the range of the last five years (2005/06: 13.0%). Expense leverage of 70 basis points from like for like sales growth partly offset the impact of additional immature space of 50 basis points as well as the adverse effect of both the movement in gross margin percentage of 70 basis points and the 53rd week of 20 basis points.

Expense leverage was curtailed by an above normal level of increase in healthcare costs, freight charges and property taxes. The bad debt charge was 2.8% of total sales (2005/06: 3.0%). The proportion of sales through the in-house credit card was 51.7% (2005/06: 51.6%).

The movement in gross margin percentage reflected the adverse impact of higher commodity costs, changes in mix and a slightly more competitive pricing environment in the fourth quarter. In 2006/07 gold prices increased significantly, however, diamond prices were broadly stable. The variance in mix reflected the growth of Jared and an increase in diamond participation, both of which are driving like for like sales growth and expense leverage. All of these factors were partly offset by supply chain initiatives, and selective pricing changes predominantly implemented in the second quarter of 2006/07.

ROCE was 21.5% (2005/06: 22.4%) reflecting the additional investment in an 11% increase in space. The proportion of stores under six years old in 2006/07 was 32% compared to 22% in 2001/02 (treating the acquired Marks & Morgan sites as existing stores). The higher proportion of immature store space constrains the ROCE in the short term, but increases operating profit and drives future growth.

Store operations

During 2006/07 the first phase of an enhanced training system to develop customer service skills and product knowledge further, was introduced into the stores; the systems for training jewellery repair staff were improved; and a customer satisfaction index was included in the monthly performance indicators for each store. Store staff also received additional training on supply chain issues such as conflict diamonds and the environmental impact of gold mining.

Merchandising

Average unit selling prices in mall stores and Jared increased by 4% and 3% respectively, reflecting selective changes in retail prices as a result of increased commodity costs. This was partly offset by the rapid growth of the heavily promoted "Circle" and "Journey" merchandise, the latter being a new range launched in conjunction with a marketing campaign by the Diamond Trading Company. The right hand diamond ring selection was increased and the upper end of the diamond collection continued to be successfully developed. In Jared, the "Peerless Diamond" was introduced into all stores and the luxury watch ranges were further extended. The rough diamond sourcing trial, the objective of which is to secure additional reliable and consistent supplies of diamonds at a lower cost, was increased over the prior year and will be expanded further in 2007/08.

Marketing

Annual gross marketing spend amounted to 7.0% of sales (2005/06: 6.7%). Dollar marketing expenditure increased by 21% reflecting the growth in total sales, the higher proportion of sales being generated by Jared and the impact of the commencement of television advertising for Valentine's Day 2007 in the 53rd week. Further leverage of the "Every kiss begins with Kay" advertising campaign continued to help drive sales performance. The JB Robinson television advertising test was expanded to a further three markets; the other markets with regional brands continued to be supported by radio advertising. National cable television advertising was used by Jared stores for the first time during the holiday period and the "He went to Jared" campaign was further developed. It is expected that Jared will have sufficient scale to move to national network television advertising in the fourth quarter of 2007/08.

Kay Jewelers

Kay sales increased by 15.2% to $1,486.7 million (2005/06: $1,290.1 million). During the year a further net 51 stores were opened, bringing the total to 832. Following a successful three year trial of 31 sites, the roll-out of Kay stores in open-air retail centres began with 21 opened in 2006/07; a further 35 – 40 are planned for 2007/08. Due to the division's strict real estate criteria, no new stores in metropolitan locations were opened in 2006/07; the three metropolitan locations opened in 2005/06 traded satisfactorily. The test of Kay stores in outlet centres started with four additional sites. A trial of a mall superstore format, drawing on the experience of Jared and the metropolitan store concept, was commenced in eleven locations during 2006/07. In September 2006 an e-commerce facility was successfully launched on the Kay website and will be developed further in 2007/08.

Regional brands

341 mall stores traded under strong regional brand names at 3 February 2007 with sales up 3.4% to $501.0 million (2006/07: $484.5 million). There are now 114 JB Robinson locations; 19 stores were rebranded to that format during 2006/07 as part of the test of local television advertising. The regional brands continue to significantly outperform the speciality jewellery sector average sales per store.

Jared The Galleria Of Jewelry

Jared sales were up by 24.4% to $664.4 million (2005/06: $534.2 million); the portfolilo of 135 stores, equivalent in space terms to about 550 mall stores, increased by 25 during 2006/07. The Jared concept again accounted for the majority of the Group's space growth. The chain is immature with only 41% of stores having traded for five or more years. In their fifth year of trading the average sales of these stores was some $5.6 million, above the target level set at the time of the original investment. The average sales per store for those Jared locations that have been open for six years or more was $6.8 million in 2006/07. Jared's average store contribution rate was broadly similar to that of the division as a whole.

In 2006/07, Jared entered nine new markets, the largest being Los Angeles. Representation was expanded in eight cities, including Boston, Chicago, Baltimore and Denver. It is planned to enter the major centres of New York and Philadelphia in 2007/08.

Real estate

The table below sets out the store numbers, net new openings and the potential number of stores by chain:

Number of stores	28 January 2006	Net openings 2006/07	3 February 2007	Planned net openings 2007/08	Potential
Kay					
Mall	746	26	**772**	25-30	850+
Off-mall	31	21	**52**	35-40	500+
Outlet	1	4	**5**	5	50-100
Metropolitan	3	nil	**3**	nil	30+
	781	51	**832**	65-75	1,430+
Regionals	330	11	**341**	5	c.700
Jared	110	25	**135**	20-25	250+
Total	1,221	87	**1,308**	90-105	2,380+

Investment

In 2006/07 fixed capital investment was $101.1 million (2005/06: $88.4 million), including some $57 million related to new store space. In 2007/08 capital expenditure is planned to rise to about $135 million, including circa $65 million related to new space. The investment in working capital, that is inventory and receivables, associated with space growth amounted to some $119 million in 2006/07 and is expected to be higher in 2007/08. 59 stores were refurbished or relocated (2005/06: 57) with some 77 planned for 2007/08. During 2006/07, a two year project to increase the capacity of the distribution centre was completed on schedule.

Recent investment in the store portfolio, both fixed and working capital, is set out below:

	2006/07 $m	2005/06 $m	2004/05 $m
New stores			
Fixed capital investment	**57**	45	27
Working capital investment	**119**	96	76
Total investment	**176**	141	103
Other store fixed capital investment	**30**	28	29
Total store investment	**206**	169	132

UK division (25% of Group sales)

Details of the UK division's results are set out below:

	2006/07 53 weeks £m	2005/06 52 weeks £m	Change %	Like for like change %
Sales: H.Samuel	**260.8**	256.2	1.8	0.7
Ernest Jones	**217.6**	208.5	4.4	1.7
Other	**4.1**	4.9	(16.3)	
Total	**482.5**	469.6	2.7(1)	1.2
Operating profit	**55.0**(1)	49.1	12.0(1)	
Operating margin	**11.4%**	10.5%		
ROCE	**32.7%**	26.6%		

(1) The 53rd week contributed 1.5% to sales and 3.6% to operating profit, that is £1.8 million. See page 32 for reconciliation.

Financial performance

The UK division's operating margin was 11.4% (2005/06: 10.5%) reflecting stable sales, tight management of gross margin and strict control of costs. Gross margin percentage increased by 30 basis points, the benefit from advantageous hedging positions and selective price increases more than offsetting higher commodity costs. Actions taken to reduce costs in early 2006 benefited the business throughout 2006/07 and resulted in a 40 basis point improvement to operating margin; the impact of the 53rd week was favourable by 20 basis points.

ROCE improved to 32.7% (2005/06: 26.6%), reflecting the high leverage of capital employed in the UK division.

Store operations

An improved customer service training programme called Amazing Customer Experience ("ACE") was introduced in 2006/07 and will be developed further in 2007/08. Training for all tiers of store operations management took place to support the introduction of the ACE programme and to build general management skills. Opportunities for enhanced store procedures and employment practices were identified through a staff opinion survey. Store staff also received additional training on supply chain issues such as conflict diamonds and the environmental impact of gold mining.

Merchandising

The division focused on the development of jewellery collections and exclusive merchandise to further differentiate its brands in the marketplace. For example, in H.Samuel the Forever Diamond selection was increased, the Soulmate and Café diamond collections were introduced and there was a range of exclusive watches from Rotary. In Ernest Jones the Leo Diamond range was further expanded, the Vintage and Nature collections launched, a selection of "Journey" pieces tested and exclusive watches from manufacturers such as Emporio Armani stocked. Since 2001/02 diamond participation has risen from 17% to 23% in H.Samuel and from 33% to 38% in Ernest Jones. The average unit selling price in H.Samuel was £42 (2005/06: £38) and in Ernest Jones £163 (2005/06: £148); during the last five years average transaction values have increased by 35.4% and 36.9% respectively.

Group Chief Executive's review (continued)

Marketing
For Christmas 2006 television advertising was successfully expanded to national coverage for H.Samuel and regional support continued for Ernest Jones at a similar level to 2005/06. H.Samuel was also supported by national newspaper advertising during December 2006. Gross marketing expenditure represented 3.1% of sales in 2006/07 (2005/06: 3.2%). In September 2006 an e-commerce capability was launched on the Ernest Jones website as a complement to store-based customer service. The H.Samuel website is the most visited among speciality jewellery retailers according to Hitwise, while that of Ernest Jones is the third most visited; the e-commerce initiatives are meeting their investment targets.

Real estate and investment
During 2006/07 28 stores were refurbished or relocated, including two in the traditional design. At the year end 255 stores, mostly H.Samuel, traded in the modernised format. This type of store accounted for 44% of the UK division's sales in 2006/07. During the year 11 H.Samuel and two Ernest Jones stores were closed, and one Ernest Jones opened. At the year end there were 581 stores (375 H.Samuel and 206 Ernest Jones). The level of store capital expenditure was £8 million (2005/06: £22 million), significantly less than the prior year reflecting the phasing of the normal store refurbishment cycle and only one new store opening.

Recent investment in the store portfolio is set out below:

Number of stores	2006/07	2005/06	2004/05
Store refurbishments and relocations	28	78	81
New H.Samuel stores	–	3	2
New Ernest Jones stores	1	5	7
Store fixed capital investment	£8m	£22m	£23m

The level of store refit is planned to be at a similar level in 2007/08, with some design enhancements to the Ernest Jones format being tested. Store capital expenditure is expected to increase to some £13 million, largely reflecting a planned higher level of investment in relocations and new stores.

Terry Burman
Group Chief Executive
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